2002

University of Maine System Annual Financial Report

University Of Maine System

UNIVERSITY OF MAINE SYSTEM

ANNUAL FINANCIAL REPORT

FOR THE YEAR ENDED JUNE 30, 2002

Additional copies are available at http://www.maine.edu/oft or by contacting:

Office of Finance and Treasurer
107 Maine Avenue
Bangor, ME 04401-4380

In complying with the letter and spirit of applicable laws and in pursuing its own goals of diversity, the University of Maine System shall not discriminate on the grounds of race, color, religion, sex, sexual orientation, national origin or citizenship status, age, disability, or veterans status in employment, education, and all other areas of the University. The University provides reasonable accommodations to qualified individuals with disabilities upon request.

Questions and complaints about discrimination in any area of the University should be directed to Sally Dobres, Equal Opportunity Coordinator, University of Maine System, Office of Human Resources, 107 Maine Avenue, Bangor, Maine 04401 (207) 621-3199 (voice) or (207) 973-3300 (TTY/TDD). Inquiries or complaints about discrimination in employment or education may also be referred to the Maine Human Rights Commission. Inquiries or complaints about discrimination in employment may be referred to the U.S. Equal Employment Opportunity Commission.

Inquiries about the University's compliance with Title VI of the Civil Rights Act of 1964, which prohibits discrimination on the basis of race, color, and national origin; Section 504 of the Rehabilitation Act of 1973 and Title II of the Americans with Disabilities Act of 1990, which prohibit discrimination on the basis of disability; Title IX of the Education Amendments of 1972, which prohibits discrimination on the basis of sex; and the Age Discrimination Act of 1975, which prohibits discrimination on the basis of age, may also be referred to the U.S. Department of Education, Office for Civil Rights (OCR), Boston, MA 02109-4557, telephone (617) 223-9662 (voice) or (617) 223-9695 (TTY/TDD). Generally, an individual may also file a complaint with OCR within 180 days of alleged discrimination.

UNIVERSITY OF MAINE SYSTEM
2002 ANNUAL FINANCIAL REPORT

TABLE OF CONTENTS

MISSION

The University of Maine System unites seven distinctive public universities in the common purpose of providing first-rate higher education at reasonable cost in order to improve the quality of life for the citizens of Maine. The System, through its Universities, carries out the traditional tripartite mission – teaching, research, and public service. As a System, it extends its mission as a major resource for the State, linking economic growth, the education of its people, and the application of research and scholarship.

UNIVERSITY OF MAINE SYSTEM UNIVERSITIES & CENTERS/COLLEGES

The University of Maine System is a comprehensive public institution of higher education serving approximately 33,000 students and is supported by the efforts of 1,391 regular full-time faculty, 98 regular part-time faculty, 3,195 regular full-time staff, and 397 regular part-time staff members. Nationally recognized as a leader in combining excellence with access in public higher education, the System consists of the following seven universities:

University of Maine (UM)
University of Maine at Augusta (UMA)
University of Maine at Farmington (UMF)
University of Maine at Fort Kent (UMFK)
University of Maine at Machias (UMM)
University of Maine at Presque Isle (UMPI)
University of Southern Maine (USM)

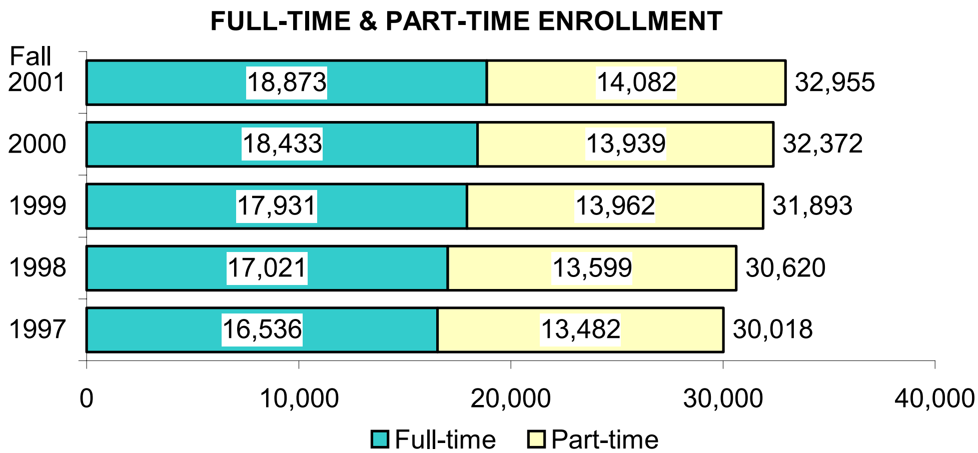
The Lewiston-Auburn College is administered by the University of Southern Maine and houses both University of Southern Maine and University of Maine at Augusta programs. The University College of Bangor is also a campus of the University of Maine at Augusta.

University College offers access to quality public higher education statewide. Students may participate in interactive television (ITV) at several receiving sites throughout the State or may attend at one of the University College locations below that offers both on-site and ITV instruction.

Bath/Brunswick
Calais
Dover-Foxcroft
East Millinocket
Ellsworth
Houlton
Saco/Biddeford
Sanford
Rumford/Mexico
Thomaston

STUDENT ENROLLMENT

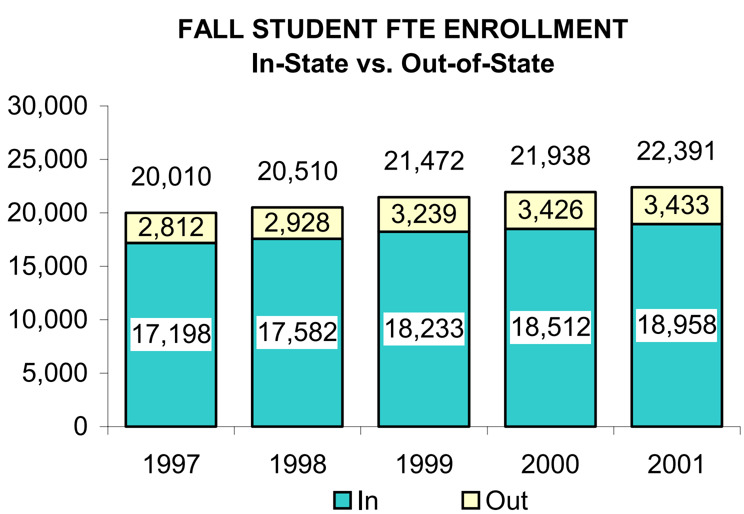
Once again, the University of Maine System experienced a growth in enrollment. 32,955 students were enrolled for the Fall 2001 semester, as compared to 32,372 for the Fall 2000 semester, which represents a 2% increase. Of the total student population, 57% are enrolled on a full-time basis and 88% of those enrolled were Maine residents.



Fall full-time equivalent (FTE) enrollment totaled 22,391 and also increased 2% above the previous year's total of 21,938.

FALL 2001 FTE BY UNIVERSITY

UM	8,335	UMFK	694
UMA	2,690	UMM	653
UMF	2,117	UMPI	1,058
USM	6,844		



Student Costs

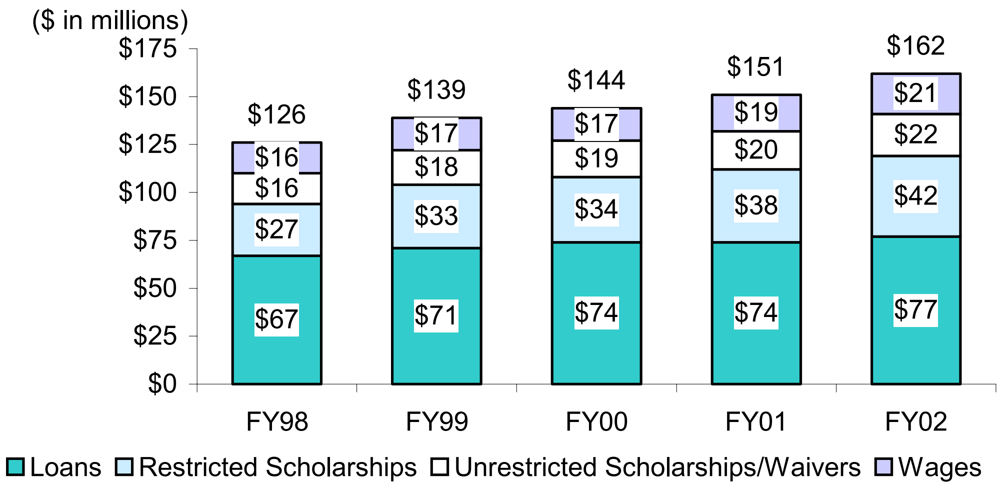
2001/2002 COMPREHENSIVE COST OF EDUCATION

Undergraduate	Annual Tuition	Mandatory Fees	Total Tuition & Mandatory Fees*	Room & Board	Total
In-State					
UM	$4,200	$917	$5,117	$5,728	$10,845
UMA	3,270	435	3,705	-	-
UMF	3,735	492	4,227	4,846	9,073
UMFK	3,270	344	3,614	4,224	7,838
UMM	3,270	485	3,755	4,644	8,399
UMPI	3,270	430	3,700	4,264	7,964
USM	3,855	602	4,457	5,466	9,923
Weighted Average	**3,811**	**661**	**4,472**	**5,411**	**9,883**
Out-of-State					
UM	$11,970	$917	$12,887	$5,728	$18,615
UMA	7,980	435	8,415	-	-
UMF	9,120	492	9,612	4,846	14,458
UMFK	7,980	344	8,324	4,224	12,548
UMM	8,250	485	8,735	4,644	13,379
UMPI	7,980	430	8,410	4,264	12,674
USM	10,770	602	11,372	5,466	16,838
Weighted Average	**10,408**	**661**	**11,069**	**5,411**	**16,480**
Graduate					
In-State					
UM	$3,780	$520	$4,300	$5,728	$10,028
USM	3,465	320	3,785	5,466	9,251
Weighted Average	**3,608**	**425**	**4,033**	**5,716**	**9,749**
Out-of-State					
UM	$10,782	$520	$11,302	$5,728	$17,030
USM	9,684	320	10,004	5,466	15,470
Weighted Average	**10,633**	**425**	**11,058**	**5,716**	**16,774**
Law School					
In-State	$10,200	$564	$10,764	$5,466	$16,230
Out-of-State	18,150	564	18,714	5,466	24,180

* Annual tuition & mandatory fees are based on 15 credit hours per semester for two semesters for under-graduate and law students and on 9 credit hours per semester for two semesters for graduate students.

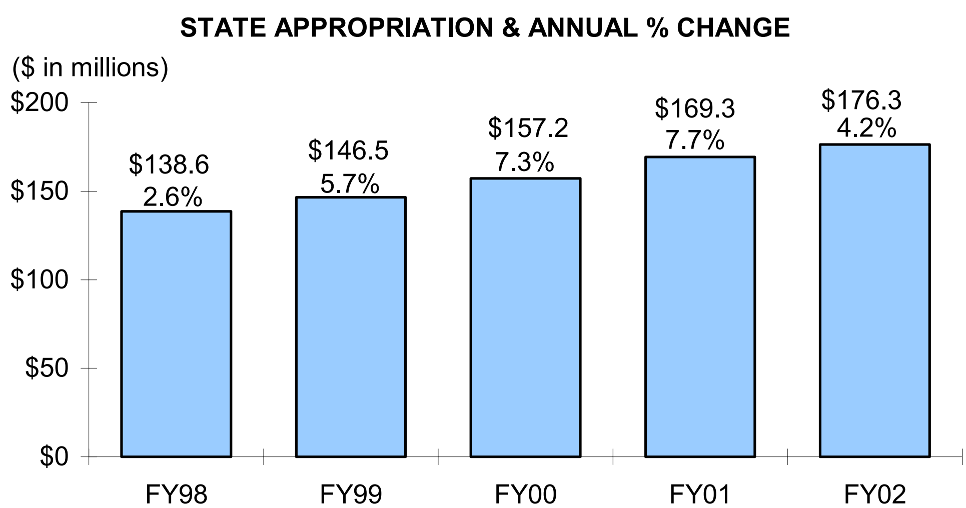
STUDENT FINANCIAL AID

During FY02, more than 25,000 students received some form of financial aid assistance. The total financial aid received by students increased by more than 7% from $151 million in FY01 to $162 million in FY02. Of the $77 million awarded in student loans, $70 million were federally funded FFELP and Direct Loans.



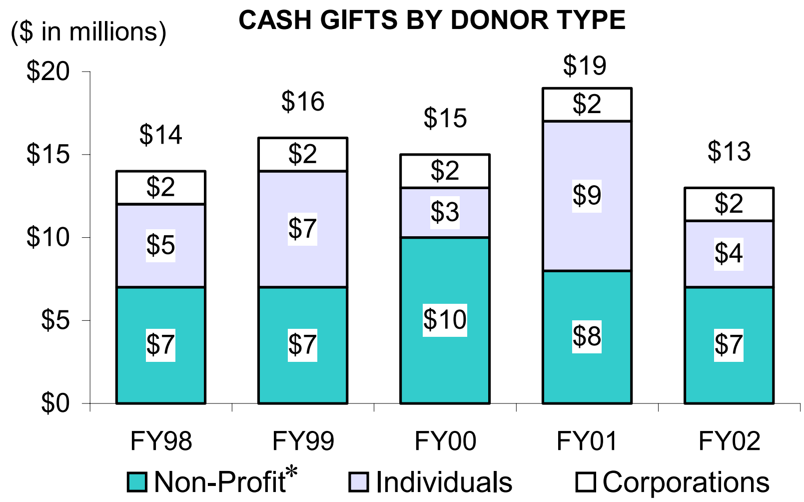
STATE APPROPRIATION

The Educational & General State Appropriation to the University of Maine System has continued to increase over the past 5 years. Over the past 5 years, the State Appropriation to the System averaged 6.9% of the State's Undedicated General Fund Revenues.



GIFTS

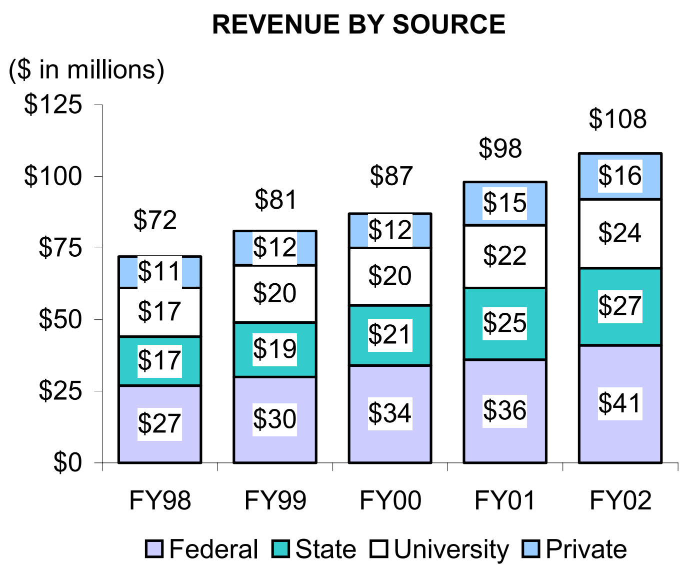
Total cash gifts decreased by $6 million from FY01 to FY02 with the majority attributable to the decrease in individual gifts. It should be noted, however, that the total amount of individual gifts received during FY01 included a single-donor contribution of $5 million.

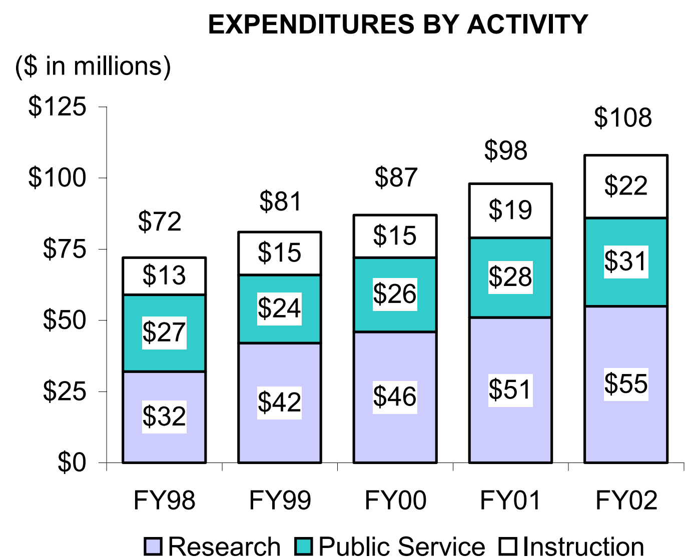


*Non-Profit includes foundations, governmental agencies, and other non-profit groups.

SPONSORED PROGRAMS

Sponsored programs revenue increased 10% and totaled $108 million for FY02. Federal funding accounted for 38% of the total sponsored programs revenue. During FY02, 51% of all sponsored programs expenditures were for research.

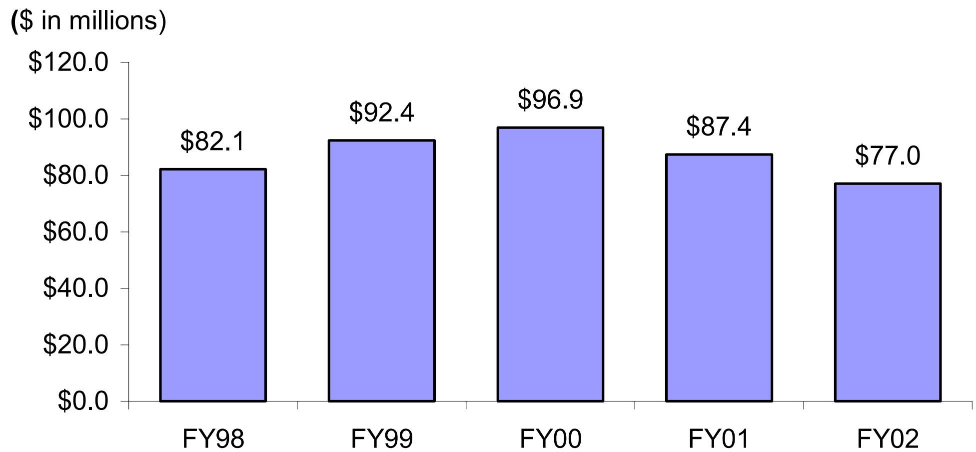




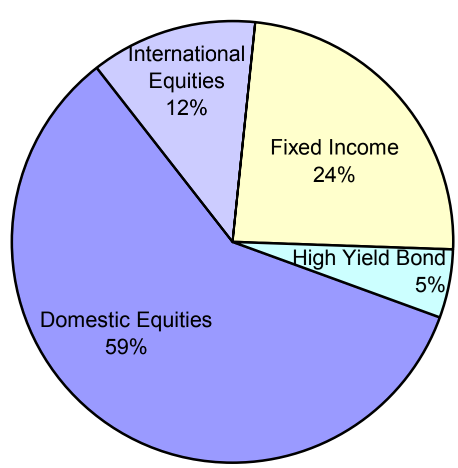
ENDOWMENT

Endowments are gifts received from donors who stipulate that the original amount of the gift (principal) cannot be expended but the income earned and related appreciation can be expended. If the donor established criteria to determine how the expendable amounts can be used, then the endowment is restricted. If the use of funds is left to the discretion of the System, the endowment is considered unrestricted. The vast majority of gifts received are placed in a single investment pool, and investment income is allocated to each endowed fund based on its pro-rata share of the pool.

MARKET VALUE OF POOLED ENDOWMENT INVESTMENTS



The endowment fund is diversified by asset class to minimize risk while optimizing return. Following is the asset allocation as of June 30, 2002:



The following discussion and analysis provides an overview of the financial position of the University of Maine System ("the System") for the year ended June 30, 2002, with selected comparative information for the year ended June 30, 2001. This analysis has been prepared by management and should be read in conjunction with the financial statements and notes thereto which are also presented in this document.

Overview of the Financial Statements

The University of Maine System's financial statements include three primary components: 1) the Statement of Net Assets, 2) the Statement of Revenues, Expenses, and Changes in Net Assets, and 3) the Statement of Cash Flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles. As of July 1, 2001, the System adopted GASB Statements 34, 35, 36, 37, and 38 as described in the Notes to Financial Statements. Prior to the issuance of these statements, the financial statements focused on the accountability of individual fund groups. With the implementation of these changes, the System will now produce statements with a consolidated format. The objectives of these changes are to increase comparability, understandability, and relevance and to focus on the institution as a whole.

Revenues and expenses are now categorized as either operating or nonoperating. Significant recurring sources of revenue such as state appropriations, gifts, and investment income or loss are considered nonoperating. Scholarships and fellowships applied to student accounts are now shown as a reduction of student tuition and fee revenues while stipends and other payments made directly to students continue to be presented as student aid expenses. Previously, all scholarships and fellowships were presented as expenses.

Net Assets

The Statement of Net Assets presents the financial position of the System at the end of the fiscal year and includes all assets and liabilities of the System. Net assets represent the difference between total assets and total liabilities and is one indicator of the current financial condition of the System. The change in net assets is an indicator of whether the overall financial condition has improved or deteriorated during the year. Assets and liabilities are generally measured in current values. A summarized comparison of the System's assets, liabilities, and net assets at June 30, 2002 and 2001 is as follows:

	2002	2001	Change
		($ in thousands)	
Current assets	$ 152,253	$ 143,449	$ 8,804
Noncurrent assets:			
Endowment	77,435	87,919	(10,484)
Capital assets	356,995	326,471	30,524
Other noncurrent assets	109,272	83,512	25,760
Total assets	695,955	641,351	54,604
Current liabilities	58,026	49,776	8,250
Noncurrent liabilities:			
Long-term debt	126,764	85,222	41,542
Other noncurrent liabilities	56,184	54,561	1,623
Total liabilities	240,974	189,559	51,415
Net Assets:			
Invested in capital assets, net of debt	285,320	268,984	16,336
Restricted - nonexpendable	43,970	42,725	1,245
Restricted - expendable	79,635	99,573	(19,938)
Unrestricted	46,056	40,510	5,546
Total net assets	$ 454,981	$ 451,792	$ 3,189

Net assets invested in capital assets, net of related debt, represent the System's capital assets less the accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets. The $16,336 increase in this category of net assets reflects the System's commitment to the renewal and expansion of its capital assets and the overall growth of the institution.

Restricted nonexpendable net assets represent the System's permanent endowment funds. The $1,245 increase is the result of $1,356 in new gifts less various reclassifications and transfers. Restricted expendable net assets include such items as student financial aid, research, and public service and are subject to externally imposed conditions on spending. Declining market conditions impacting the endowment fund combined with increased spending for property, plant, and equipment are the primary drivers behind this $19,938 reduction.

Although unrestricted net assets are not subject to externally imposed stipulations, a portion has been earmarked for various institutional programs. The $5,546 change in unrestricted net assets is attributable to Educational & General and Auxiliary Operations.

Endowment Investments (Noncurrent Assets)

The System's endowment investments had a fair market value of $77,435 at June 30, 2002 reflecting a decrease of $10,484. The total return on the pooled endowments on a net of fees basis for fiscal year 2002 was –9.1% as compared to –7.9% for fiscal year 2001. The continued decrease is primarily the result of the significant declines suffered in the equities markets, with the endowment experiencing an unrealized loss of $7,802 during the past fiscal year.

The System manages its endowment to generate a predictable stream of annual support for current needs, while at the same time preserving the endowment as a whole to ensure funds for future years. The endowment spending rate policy provides for an annual distribution of 5.5% of the average net market value of the endowment for the prior 12 quarters.

Capital Assets and Debt Activities

One of the essential components of providing quality academic programs, research programs, and residential life at the universities is the improvement of capital assets. The System is continually implementing its long-term capital plan to upgrade older facilities and construct new facilities when necessary.

Capital additions before depreciation totaled $56,224 in 2002. Capital additions primarily consist of replacement, renovation, and new construction of academic, housing, and research facilities as well as investments in equipment, including information technology. Current year capital asset additions were funded primarily with capital appropriations and University of Maine System revenue bonds.

Of the total capital additions before depreciation, $44,413 represented capital construction. Some of the residential hall projects under construction or renovation included the Doris Twitchell Allen Village – Phase II (UM) and Scott Hall (UMF). Classroom construction or renovation included the Engineering/Science Research Complex, Hitchner Hall, and Aubert Hall at UM. Projects in progress also included the Enterprise Resource Planning (ERP) project. ERP software will integrate information and business processes to enable the efficient and effective sharing of information throughout the organization and, thus, maximize productivity.

The System's total debt as of June 30, 2002 was $131,247. Of this amount, $130,856 was in the form of bonds and included the May 2002 revenue bond issuance of $45,680. Coinciding with this bond issuance, the System entered into a 10-year variable rate interest swap agreement, thus creating synthetic variable rate debt for the life and amount of the 2002 bond. The System manages all its financial resources effectively including the prudent use of debt to finance capital projects that support the System's mission, thereby placing the System in a better position to achieve its strategic goals.

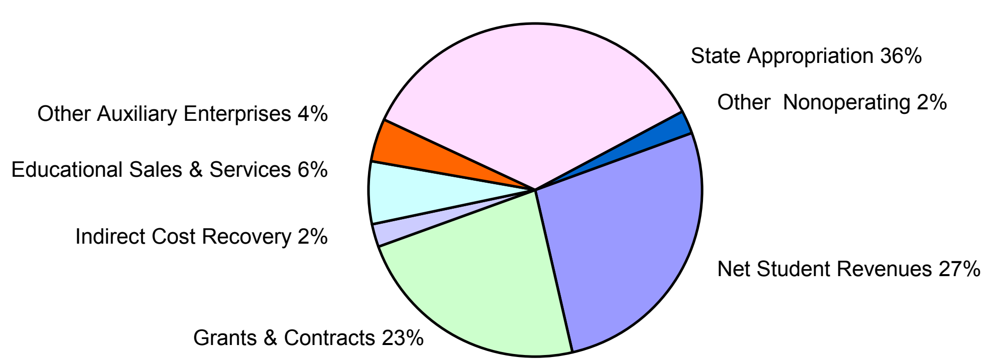
Revenues and Expenses

	2002	2001
	($ in thousands)	
Operating Revenues:		
Net student revenues	$ 134,612	$ 123,395
Grants and contracts	113,550	104,099
Indirect cost recovery	10,816	9,243
Educational sales and services	30,824	30,335
Other auxiliary enterprises	20,392	18,724
Interest income on loans	739	725
Total operating revenues	310,933	286,521
Operating Expenses	498,322	472,011
Net operating loss	(187,389)	(185,490)
Non-operating revenues (expenses):		
State appropriation - general	176,388	169,319
Gifts	11,037	10,284
Endowment income (loss)	(7,067)	(7,474)
Investment income	6,602	10,338
Interest expense	(4,079)	(3,834)
Net nonoperating revenues(expenses)	182,881	178,633
Income (loss) before capital and endowment related items	$ (4,508)	$ (6,857)

In addition to receiving tuition and fees, the System receives revenue from several other diverse sources such as governmental and privately funded sponsored programs, gifts from individuals, foundations, and corporations, state appropriations, and investment income. The System will continue to seek funding from all sources that will supplement student tuition and thereby allow for the enhancement of its educational offerings and research capabilities.

The following graph illustrates both the operating and nonoperating revenue sources used to fund the System's activities for the year ended June 30, 2002.

TOTAL OPERATING & NONOPERATING REVENUE
$497,893



Operating Revenues

Tuition and fees and residence and dining fees are the primary sources of operating revenue and totaled $134,612 after adjusting for scholarship allowances, reflecting an increase of $11,217 or 9.1% over fiscal year 2001 revenue. This change is the result of a 3.9% weighted average increase in tuition, a 6.5% weighted average increase in room and board rates, and an increase in student enrollment and students residing in residence halls.

Sponsored programs revenues increased 9.1% in 2002 as state research and development funding continued to leverage federal dollars. The System receives funding from federal, state, and private sources with the majority of the funding being provided by the federal government for research activities. Funding received from these sources also provides for recovery of indirect costs associated with sponsored programs.

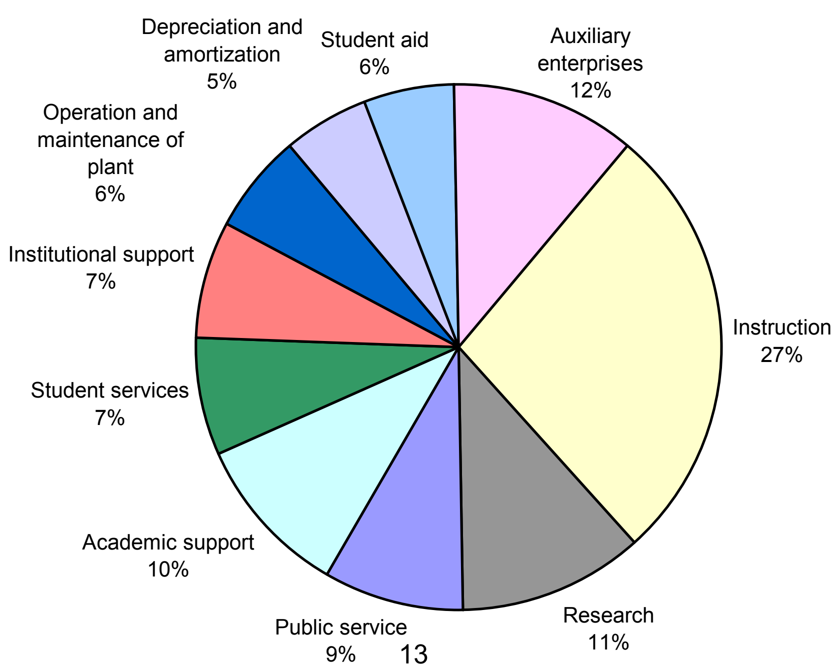
Although not considered an operating revenue, the general state appropriation is the largest funding source for educational and general operations and increased $7,069 or 4.2% to $176,388. The general state appropriation for fiscal year 2002 covered 94% of the net operating loss.

Operating Expenses

The 2002 operating expenses, classified by function, are as follows:

	($ in thousands)
Instruction	$135,506
Research	57,150
Public service	42,386
Academic support	50,205
Student services	35,214
Institutional support	37,350
Operation and maintenance of plant	29,671
Depreciation and amortization	25,736
Student aid	28,156
Auxiliary enterprises	56,948
Total	$498,322

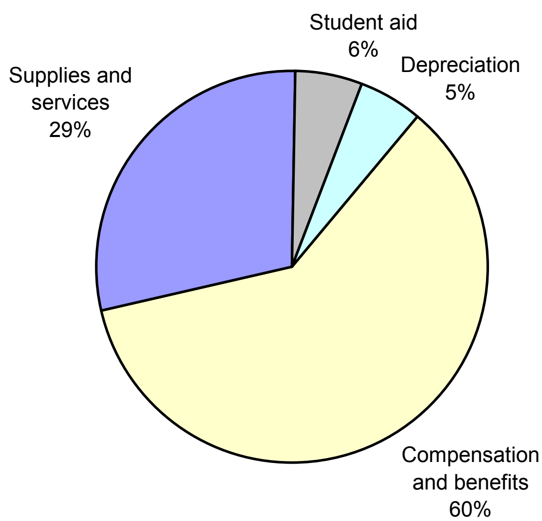
Operating Expenditures
Functional Classification
$498,322



Although the System reports expenses based on a functional classification, a comparative summary of the System's expenses based on a natural classification for the years ended June 30, 2002 and 2001 is as follows:

	2002	2001
	($ in thousands)	
Operating:		
Compensation and benefits	$ 300,307	$ 284,671
Supplies and services	144,123	134,431
Student aid	28,156	26,903
Depreciation	25,736	26,006
	498,322	472,011
Nonoperating:		
Interest	4,079	3,834
Total Expenses	$ 502,401	$ 475,845

FY02 Operating Expenditures
Natural Classification
$498,322



The System is committed to recruiting and retaining an outstanding faculty and staff; therefore, it is crucial that the System offers a competitive compensation package in order to successfully compete with other educational institutions as well as public and private non-educational entities. The amount expended for compensation and benefits increased $15,636 or 5.5% for 2002. This increase is due primarily to annual employee compensation increases, increased health-care costs for both current employees and retirees, and a 3.6% increase in faculty to support the increased student enrollment and growth in sponsored programs. The System continues to work with the State of Maine and other employers to minimize health care costs while also providing quality health-care coverage to employees and retirees. The 6.2% increase in dormitory occupancy for 2002 generated additional revenues but also resulted in additional supplies and services expenditures.

The System has undertaken an extensive and concerted effort to reduce costs wherever possible - especially in light of the uncertainty in future state appropriations and the growing concerns over increased health-care costs.

Cash Flows

An analysis of cash flows provides additional information about the System's financial results by reporting the major sources and uses of cash. A comparative summary of cash flows for the years ended June 30, 2002 and 2001 is a follows:

Cash, cash equivalents, short-term investments, and unexpended bond proceeds:

	2002	2001
	($ in thousands)	
Operating/noncapital activities	$ 38,052	$ 22,805
Financing activities:		
Bond issuance	45,680	41,505
State appropriation-capital	6,788	19,608
Capital gifts and grants	3,632	7,239
Net provided by financing activities	56,100	68,352
Capital purchases	(52,661)	(45,624)
Net increase in cash, cash equivalents, and short-term investments	41,491	45,533
Beginning balance	136,481	90,948
Ending balance	$ 177,972	$ 136,481
Cash and cash equivalents	$ 7,234	$ 1,129
Short-term investments	113,416	105,610
Deposits with bond trustees (unexpended bond proceeds)	57,322	29,742
Ending balance	$ 177,972	$ 136,481

The System's cash, cash equivalents, short-term investments, and unexpended bond proceeds increased $41,491 due to the positive flow of funds provided by operating activities and bond issuance proceeds offset by a reduction in capital appropriations and gifts/grants and increased capital acquisition and construction. The primary source of cash included in operating/noncapital activities is the state appropriation, which is used to fund operating activities.

Impact of Future Economic Factors

It is management's opinion that the System's financial condition will remain strong and that sufficient strategies are in place to continue to provide excellent educational opportunities for both current and prospective students as well as assist in strengthening the Maine economy through various research and development projects. Although the System is continuing to seek additional state support, it is also exploring new avenues to increase its revenue base.

The System faces increasing financial pressure to offer competitive salaries that will facilitate attracting and retaining highly developed faculty and staff. Added to this pressure is the dramatic escalation of health-care costs over the past year and into the future for both current employees and retirees. The System will continue to negotiate with health-care providers to obtain the lowest costs combined with the best comprehensive plan as well as seek to develop new partnerships with other employers to help reduce the System's burden in this area.

With the inauguration of a new governor in 2003 as well as new legislative members, the System will continue to promote the cause of higher education to both new and veteran elected officials. For 2002, the System's operating loss, which excludes the state appropriation, was $187,389. The state appropriation reduced that loss by 94%. Since there is a correlation between the amount of state financial support received by the System and the amount of educational costs borne by the students, the System will continue to persevere to obtain increased state support in order minimize tuition charges.

The System remains committed to its long-term capital plan to revitalize existing facilities and undertake new construction. The capital plan addresses both the System's potential growth and need to provide technologically advanced research and teaching facilities. The System will continue to seek refinancing opportunities. If advantageous, the System may seek additional interest swap agreements. These are popular tools for managing interest rate risk and can be used to lower fixed debt service costs by converting fixed rate debt into variable rate debt. They are also useful for improving balance sheet management, since the interest rates on variable rate debt will fluctuate in a similar fashion to the interest rates being earned on assets that are invested on a short-term basis.

Private gifts supplement funding received from the state appropriation and tuition. The System is implementing a gift annuity program to increase giving opportunities while providing additional financial benefits for the donors. Future economic conditions, however, may impact the amount of donations made to the System.

Auxiliary enterprises, which are designed to be self-supporting, continue to generate revenue in excess of expenditures. With the anticipated growth in student enrollment, it is expected that auxiliary enterprises will continue to expand in the future.

The System will continue to implement its long-term investment strategy of maximizing total returns in conjunction with appropriate risk levels while maintaining a spending rate policy that will protect the System's funds from temporary market volatility.

While it is impossible to predict the financial future of the System, management believes that the System has positioned itself both financially and strategically to persevere in times of future economic uncertainties.

99 High Street
Boston, MA 02110-2371

Telephone 617 988 1000
Fax 617 988 0800

Independent Auditors' Report

The Board of Trustees
University of Maine System:

We have audited the accompanying statement of net assets of the University of Maine System (the System) (a component unit of the State of Maine) as of June 30, 2002, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in notes 1 and 15, the System adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, as of July 1, 2001.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Maine System as of June 30, 2002, and the respective changes in financial position and cash flows therof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 13, 2002 on our consideration of the University of Maine System internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis on pages 9 to 16 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

September 13, 2002

UNIVERSITY OF MAINE SYSTEM
Statement of Net Assets
June 30, 2002
($ in thousands)

ASSETS

Current Assets:	
Cash and cash equivalents (Note 2)	$ 7,234
Short-term investments (Note 3)	113,416
Accounts, grants, and pledges receivable, net (Note 4)	26,808
Inventories and prepaid expenses	4,795
Total Current Assets	152,253
Noncurrent Assets:	
Deposits with bond trustees (Notes 3 and 6)	64,287
Accounts, grants, and pledges receivable, net (Note 4)	6,272
Notes receivable, net (Note 5)	37,371
Endowment investments (Note 3)	77,435
Bond costs, net	1,342
Capital assets, net (Note 6)	356,995
Total Noncurrent Assets	543,702
Total Assets	$695,955

LIABILITIES

Current Liabilities:	
Accounts payable	$ 11,355
Deferred revenue and deposits	18,390
Accrued liabilities (Note 7)	23,291
Funds held for others	507
Current portion of capital lease obligations (Note 7)	171
Current portion of bonds payable (Note 7)	4,312
Total Current Liabilities	58,026
Noncurrent Liabilities:	
Accrued liabilities (Note 7)	21,985
Funds held for others (Note 3)	2,241
Capital lease obligation (Note 7)	220
Bonds payable (Note 7)	126,544
Grant refundable (Note 8)	31,958
Total Noncurrent Liabilities	182,948
Total Liabilities	240,974

NET ASSETS

Invested in capital assets, net of related debt	285,320
Restricted for:	
Nonexpendable (Note 9)	43,970
Expendable (Notes 3 and 9)	79,635
Unrestricted	46,056
Total Net Assets	454,981
Total Liabilities and Net Assets	$695,955

The accompanying notes are an integral part of these financial statements.

UNIVERSITY OF MAINE SYSTEM
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002
($ in thousands)

REVENUES	
Operating Revenues:	
Tuition and fees	$ 132,928
Residence and dining fees	41,335
Less: scholarship allowances	(39,651)
Net student fees	134,612
Federal, state, and private grants and contracts	113,550
Recovery of indirect costs	10,816
Educational sales and services	30,824
Other auxiliary enterprises	20,392
Interest income on loans	739
Total Operating Revenues	310,933
EXPENSES	
Operating Expenses:	
Instruction	135,506
Research	57,150
Public service	42,386
Academic support	50,205
Student services	35,214
Institutional support	37,350
Operation and maintenance of plant	29,671
Depreciation and amortization	25,736
Student aid	28,156
Auxiliary enterprises	56,948
Total Operating Expenses	498,322
Operating Loss	(187,389)
NONOPERATING REVENUES (EXPENSES)	
State appropriations	176,388
Gifts	11,037
Endowment income (loss) (Note 3)	(7,067)
Investment income (Note 3)	6,602
Interest expense	(4,079)
Net Nonoperating Revenue	182,881
Income Before Other Revenues, Expenses, Gains, and Losses	(4,508)
OTHER REVENUES, EXPENSES, GAINS, AND LOSSES	
Capital appropriations	3,035
Capital grants and gifts	3,306
Additions to permanent endowments - gifts	1,356
Total Other Revenues, Expenses, Gains, and Losses	7,697
Increase in Net Assets	3,189
NET ASSETS	
Net Assets - beginning of year (Note 15)	451,792
Net Assets - end of year	$ 454,981

The accompanying notes are an integral part of these financial statements.

University of Maine System
Statement of Cash Flows
For the Year Ended June 30, 2002
($ in thousands)

CASH FLOWS RELATED TO OPERATING ACTIVITIES:	
Tuition, residence, dining, and other student fees	$ 134,435
Grants and contracts	132,212
Educational sales and services	30,763
Other auxiliary enterprise revenues	20,373
Payments to and on behalf of employees	(304,691)
Financial aid paid to students	(28,301)
Payments to suppliers	(136,691)
Loans issued to students	(6,852)
Collection of loans to students	5,891
Interest collected on loans to students	739
Other operating receipts	425
Net Cash Used For Operating Activities	(151,697)
CASH FLOWS RELATED TO NONCAPITAL FINANCING ACTIVITIES:	
State appropriations	176,388
Noncapital grants and gifts	10,149
Gifts and appropriations received for permanent endowment	1,356
Agency transactions	1,623
Net Cash Provided By Noncapital Financing Activities	189,516
CASH FLOWS RELATED TO CAPITAL AND RELATED FINANCING ACTIVITIES:	
Proceeds from bond issuance	46,238
Capital appropriations	6,788
Capital grants and gifts	3,632
Acquisition and construction of capital assets	(52,661)
Bond costs	(558)
Principal paid on capital debt	(3,911)
Interest paid on capital debt	(4,914)
Net Cash Used For Capital and Related Financing Activities	(5,386)
CASH FLOWS RELATED TO INVESTING ACTIVITIES:	
Proceeds from sales and maturities of investments	306,016
Purchase of investments	(340,388)
Earnings from investments	8,044
Net Cash Used For Investing Activities	(26,328)
Cash and cash equivalents - beginning of year	1,129
Cash and cash equivalents - end of year	$ 7,234

The accompanying notes are an integral part of these financial statements.

University of Maine System
Statement of Cash Flows
For the Year Ended June 30, 2002
($ in thousands)

Reconciliation of net operating loss to net cash used by operating activities:

Operating loss	$ (187,389)
Adjustments to reconcile net loss to net cash used by operating activities:	
Depreciation and amortization expense	25,736
Change in assets and liabilities:	
Accounts and grants	5,238
Inventories	(640)
Notes receivable	(423)
Accounts payable	(64)
Deferred revenue and deposits	3,433
Accrued liabilities	2,289
Grant refundable	123
Net cash used by operating activities	$ (151,697)

The accompanying notes are an integral part of these financial statements.

1. SIGNIFICANT ACCOUNTING POLICIES

a. Organization

The University of Maine System ("the System") consists of seven Universities, ten centers, and a central administrative office. All activities of the System are included in the accompanying financial statements. Not included in the accompanying financial statements are several independent organizations which operate for the benefit of the System, including the University of Maine Foundation (Note 13) and several other foundations and alumni associations. These organizations are non-profit entities controlled by separate Governing Boards whose goals are to support the System. They receive funds primarily through donations and contribute funds to the System for student scholarships and institutional support.

b. Basis of Presentation

The accompanying financial statements of the System have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

The System records revenues from restricted grants and contracts at the time all eligibility requirements have been met.

During recent years the GASB issued several new statements on accounting standards that affect the System's financial statements for the first time in fiscal year 2002. The System has determined that it functions as a Business Type Activity, as defined in these new pronouncements. The significant GASB standards followed by the System are as follows:

In June 1999, GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* was issued. This statement establishes new financial reporting requirements. It establishes that the basic financial statements and required supplementary information (RSI) should consist of: management's discussion and analysis, basic financial statements, and required supplementary information.

In November 1999, GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities* was issued. As with Statement No. 34, it becomes effective with periods beginning after June 15, 2001. This statement establishes accounting and financial reporting standards for public colleges and universities within the financial reporting guidelines of Statement No. 34. The objective of this statement is to enhance the understandability and usefulness of the general purpose external financial reports issued by public colleges and universities. This statement requires that the System present statements of net assets; revenues, expenses, and changes in net assets; and cash flows on a consolidated, System wide, basis.

In June 2001, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus* was issued. This statement was implemented simultaneously with Statement No. 34.

In June 2001, GASB Statement No. 38, *Certain Financial Statement Note Disclosures* was issued. This statement was implemented simultaneously with Statement No. 34.

The System adopted GASB Statements 34, 35, 37, and 38 as of July 1, 2001.

The System's policy for defining operating activities in the Statement of Revenues, Expenses, and Changes in Net Assets are those that generally result from exchange transactions such as the payment received for services and payment made for the purchase of goods and services. Certain other transactions are reported as nonoperating activities in accordance with GASB Statement No. 35. These nonoperating activities include the System's operating and capital appropriations from the State of Maine, net investment income, gifts, and interest expense.

The System has elected not to adopt the pronouncements issued by the Financial Accounting Standards Board (FASB) after November 30, 1989.

c. Net Assets

GASB Statement No.34 requires that the System's net assets (assets minus liabilities) be classified for accounting purposes into the following four categories:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, repair or improvement of those assets.

Restricted – nonexpendable: Net assets subject to externally imposed conditions that the System maintain them in perpetuity.

Restricted – expendable: Net assets whose use is subject to externally imposed conditions that can be fulfilled by the actions of the System or by the passage of time.

Unrestricted: All other categories of net assets. Unrestricted net assets may be designated by actions of the System's Board of Trustees.

The System has adopted a policy of generally utilizing restricted – expendable funds, when available, prior to unrestricted funds.

d. Cash and Cash Equivalents

The System considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

e. Investments

The System's investment in the State of Maine Pool is recorded at amortized cost, which approximates the fair value. All other System investments are recorded at fair value. Dividends, interest, and realized and unrealized gains or losses on investments are reported in the Statement of Revenues, Expenses, and Changes in Net Assets.

Endowment: The System follows the pooled investment concept for its endowed funds whereby all invested funds are included in one investment pool, except for investments of certain endowed funds that are otherwise restricted and are separately invested. Investment income is allocated to each endowed fund participating in the pool based on its pro-rata share of the pool. Net assets are included in the following net asset categories:

- Restricted nonexpendable if the terms of the gift require that they be added to the principal of a permanent endowment fund.
- Restricted expendable if the terms of the gift impose restrictions on the current use of income earned on the endowment or net gains recognized on the endowment.
- Unrestricted net assets in all other cases.

The Trustee Investment Committee has established a policy whereby the Endowment's expendable income objective is 5.5% of the average of the previous twelve quarter-end market values. The income produced by the fund and realized gains can be used to meet the spending objective.

Authorized Investment Vehicles:

Short-term Investments: The Investment Committee of the University of Maine System Board of Trustees has approved the following two-tiered approach regarding the System's short-term investments:

- Cash Pool (bank accounts, state pool) – This tier consists of funds that will be needed within a one-month period, that are invested in a portfolio of highest quality short-term fixed-income securities (treasury obligations, agency securities, bankers acceptances, money market funds, CDs, commercial paper) with daily to 3-day liquidity. The average quality of the portfolio will be at least "AA".

- Intermediate Pool – This tier is invested in a diversified portfolio, in accordance with investment manager guidelines, consisting primarily of fixed income securities with a normal average duration of 1 to 3 years. Investments in the intermediate tier may consist of securities rated from 'B' to 'Aaa' quality, with a maximum of 10% below Baa and in private placements determined by the manager to be of similar credit quality. The overall average quality rating of this pool will be at least 'A'.

Endowment Investments: The fund will be diversified both by asset class and within asset classes. In order to have a reasonable probability of consistently achieving the Fund's return objectives, the following asset allocation policy has been adopted:

• Equity securities	60-80%
• Fixed income securities	20-40%
• Cash	0-10%

Deposits with bond trustees: These monies are invested in accordance with the governing bond covenants and arbitrage certificates.

f. Inventories

Inventories are stated at cost. Cost is determined using the first-in, first-out method.

g. Capital Assets

Capital assets are recorded at cost when purchased or constructed and at fair value at date of donation. In accordance with the System's capitalization policy, only equipment (including equipment acquired under capital leases) with a unit cost of $5,000 or more is capitalized. Only capital projects with a projected cost of $10,000 or more are capitalized. Library materials are generally capitalized and depreciated over a ten-year period. Interest costs on debt related to capital assets are capitalized during the construction period.

Depreciation and amortization of assets acquired under capital leases are recorded on a straight-line basis over the estimated useful lives of the related assets, principally as follows:

	YEARS
Buildings	30 - 60
Improvements	20 - 40
Equipment	5 - 15
Library books and materials	10

Costs for maintenance, repairs and minor renewals and replacements are expensed as incurred; major renewals and replacements are capitalized. Equipment and library books and materials are removed from the financial statements when they become fully depreciated. When land, buildings, and improvements are retired or otherwise disposed of, the asset and accumulated depreciation accounts are adjusted and any resulting gain or loss is reflected in the statement of revenues, expenses, and changes in net assets.

The System does not capitalize and depreciate its collections of historical treasures and works of art because it is the System's policy that:

- Works of art and historical treasures are to be held for public exhibition, education, or research in furtherance of public service, rather than for financial gain.
- Works of art and historical treasures are to be protected, kept unencumbered, cared for, and preserved.
- The proceeds from sales of works of art and historical treasures are to be used to acquire other items for the collections.

h. Deferred Revenue and Deposits

Deferred revenue in the Statement of Net Assets consists primarily of deposits and advance payments received for tuition and fees related to certain summer programs and tuition received for the following academic year. The deferred revenue is net of related expenses for the summer programs (e.g., salaries, student aid, etc.).

i. Net Student Fees

Student tuition, dining, residence, and other fees are presented net of scholarships and fellowships applied to students' accounts. Certain other scholarship amounts are paid directly to, or refunded to, the student and are generally reflected as expenses.

j. Tax Status

The University of Maine System is exempt from income taxes under Section 115 of the Internal Revenue Code as a governmental entity. It has also been recognized by the Internal Revenue Service as an organization described in Section 501(c)(3) of the Code.

k. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. CASH AND CASH EQUIVALENTS

The following summary presents the amount of the System's deposits representing cash and cash equivalents that are fully insured or collateralized with securities held by the System or by its agent in the

System's name (Category 1), those deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the System's name (Category 2), and those deposits that are not collateralized (Category 3) at June 30, 2002:

Category 1	Category 2	Category 3	Total Bank Balance	Carrying Amount
$ 5,628	$ -	$ 8,757	$ 14,385	$ 7,234

3. INVESTMENTS

The System categorizes investments according to the level of risk assumed by the System. Category 1 includes investments that are insured, registered, or held by the System or its agent in the System's name. Category 2 includes investments that are uninsured and unregistered for which the securities are held by the bank's trust department or agent in the System's name. Category 3 includes investments that are uninsured and unregistered for which the securities are held by the bank, or its trust department or agent, but not in the System's name. Unclassified investments are those with no inherent credit risk (e.g., state pool and mutual funds).

At June 30, 2002, categorization of the System's investments was as follows:

	Category 1	Category 2	Category 3	Unclassified	Total Fair Value
Short-term investments	$ -	$ 10,091	$ 15,134	$ 88,191	$ 113,416
Endowment investments			77,435		77,435
Deposits with bond trustees	21,577	6,066	36,158	486	64,287
Total Investments	$ 21,577	$ 16,157	$ 128,727	$ 88,677	$ 255,138

Income related to the System's investments for fiscal year 2002 was as follows:

	Realized Gains (Losses)	Unrealized Gains (Losses)	Investment Fees	Investment Earnings	Total
Short-term investments	$ 100	$ (56)	$ (28)	4,336	$ 4,352
Deposits with bond trustees	-	16	(1)	2,235	2,250
Total investment income	$ 100	$ (40)	$ (29)	$ 6,571	$ 6,602
Endowment investments	$ (725)	$ (7,802)	$ (484)	$ 1,944	$ (7,067)

The System's investments were comprised of the following at June 30, 2002:

	Short Term	Endowment	Bond Trustees	Total
Equities	$ -	$ 52,488	$ -	$ 52,488
Bonds	-	22,967	3,195	26,162
State pool	37,085	-	-	37,085
Mutual funds	51,106	-	-	51,106
Money funds, savings, CD's	-	1,980	1,117	3,097
Government agency obligations	25,225	-	-	25,225
Guaranteed investment contracts	-	-	59,975	59,975
Total	$ 113,416	$ 77,435	$ 64,287	$ 255,138

Short-term Investments

The System's short-term investments are available to fund operations or other purposes as deemed by System management.

Endowment Investments

Except for certain gifts invested separately at the request of the donors ($476 at June 30, 2002), the System's endowment is managed as a pooled investment fund by external investment advisors.

The University of Maine at Augusta Foundation, the University of Maine at Farmington Alumni Foundation, the University of Maine at Fort Kent Foundation, the University of Southern Maine Foundation, and the John L. Martin Scholarship Fund, Inc. have elected to participate in the System's endowment pool through a management agreement. The value of these investments at June 30, 2002 was $2,241.

As of June 30, 2002, $31,132 of total Endowment accumulated income and gains was available to the System for spending as follows:

Restricted	$25,861
Unrestricted	5,271
	$31,132

Deposit With Bond Trustees

Deposits with bond trustees are comprised of debt service reserves required by bond covenants and unexpended revenue bond proceeds.

4. ACCOUNTS, GRANTS, AND PLEDGES RECEIVABLE

Accounts receivable include the following at June 30, 2002:

	Total	Current Portion	Noncurrent Portion
Student and other accounts receivable	$ 10,623	$ 10,080	$ 543
Grants receivable	20,257	17,816	2,441
Pledges receivable	4,262	538	3,724
Total gross receivables	35,142	28,434	6,708
Less allowance for doubtful accounts	(1,785)	(1,626)	(159)
Less discount on pledges receivable	(277)	-	(277)
Net receivables	$ 33,080	$ 26,808	$ 6,272

5. NOTES RECEIVABLE

Notes receivable include the following at June 30, 2002:

Perkins Loans	$33,473
Nursing Loans	999
Institutional Loans	3,303
	37,775
Less allowance for doubtful accounts	(404)
Net Loans Receivable	$37,371

Cash flows from the above receivables may not be used to pay current liabilities (restricted for new loans); therefore, the above receivables are recorded in the accompanying Statement of Net Assets as a noncurrent asset.

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2002 was as follows:

	Beginning Balance	Additions	Reclasses	Retirements	Ending Balance
Land	$ 11,371	$ -	$ -	$ -	$ 11,371
Construction in Progress	36,019	44,413	(32,657)	-	47,775
Total Nondepreciable Assets	47,390	44,413	(32,657)	-	59,146
Land Improvements	26,334	-	1,386	-	27,720
Buildings & Improvements	315,888	-	30,746	-	346,634
Equipment	98,654	6,211	525	(11,792)	93,598
Library Materials	44,417	5,600	-	-	50,017
Total Depreciable Assets	485,293	11,811	32,657	(11,792)	517,969
Less Accumulated Depreciation:					
Land Improvements	13,115	1,322	-	-	14,437
Buildings & Improvements	108,924	7,742	-	-	116,666
Equipment	63,817	12,896	-	(11,792)	64,921
Library Materials	20,355	3,741	-	-	24,096
Total Accumulated Depreciation	206,211	25,701	-	(11,792)	220,120
Net Depreciable Assets	279,082	(13,890)	32,657	-	297,849
Total Capital Assets	$ 326,472	$ 30,523	$ -	$ -	$ 356,995

As of June 30, 2002, $57,322 in proceeds from the 1998, 2000, and 2002 revenue bond issuances remained unspent. Also remaining unspent was $34,606 in capital appropriations awarded by the State of Maine. The System receives the appropriation monies on a reimbursement basis as it spends money on applicable capital projects. Both the revenue bond and capital appropriation monies are earmarked for specific projects, some of which are included in the above capital assets.

Outstanding commitments on uncompleted construction contracts totaled approximately $22,628 at June 30, 2002.

7. LONG-TERM LIABILITIES

Long-term liabilities at June 30, 2002 consisted of the following:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Leases and bonds payable:					
Capital lease obligations	$ 47	$ 555	$ (211)	$ 391	$ 171
Bonds payable	88,877	45,682	(3,703)	130,856	4,312
Total leases and bonds payable	88,924	46,237	(3,914)	131,247	4,483
Accrued liabilities:					
Accrued vacation	9,158	1,137	-	10,295	82
Retirement incentive	10,512	1,402	-	11,914	1,737
Other	23,016	51	-	23,067	21,472
Total accrued liabilities	42,686	2,590	-	45,276	23,291
Total long-term liabilities	$ 131,610	$ 48,827	$ (3,914)	$ 176,523	$ 27,774

Lease Obligations

Future minimum lease payments under capital leases and under non-cancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2002 were as follows:

	Capital Leases		Operating
Year Ended June 30,	Principal	Interest	Leases
2003	$ 171	$ 16	$ 1,694
2004	158	8	1,084
2005	53	1	702
2006	9	-	273
2007	-	-	63
2008	-	-	14
Total minimum lease payments	$ 391	$ 25	$ 3,830

Bonds Payable

Bonds payable consisted of the following at June 30, 2002:

1993 Series A Revenue Bonds ($19,315), maturing from 1994 to 2009 with annual principal payments from $725 to $2,750 and coupon interest from 2.3% to 5.2%. Proceeds used to finance improvements to facilities ($6,000) and to prepay bonds payable to the State of Maine. The System was required to make a deposit of $1,932 representing one year of debt service, which is invested by the Bond Trustee.	$ 7,320
1993 Series B Refunding Bonds ($15,600)	
Serial Bonds, maturing from 1995 through 2009, with annual principal payments from $260 to $595 and coupon interest rates from 3.15% to 5.25%. The System was required to make a deposit of $1,129, representing one year of debt service, which is invested by the Bond Trustee.	3,595
5.50% Term Bonds due March 1, 2015	4,295
5.50% Term Bonds due March 1, 2020	4,805
Total 1993 Series B Bonds	12,695
1998 Series A Revenue Bonds ($29,540)	
Serial Bonds, maturing from 2000 to 2011, with annual principal payments from $660 to $1,050 and coupon interest rates from 3.95% to 4.75%.	7,975
5.00% Term Bonds maturing March 1, 2018	8,965
5.00% Term Bonds maturing March 1, 2024	10,540
Less: discount on 1998 Bonds	(498)
Total 1998 Series A Bonds	26,982
2000 Series A Revenue Bonds ($41,725)	
Serial Bonds, maturing from 2001 to 2015, with annual principal payments from $1,490 to $4,465 and coupon interest rates from 4.5% to 5.75%. The System was required to make a deposit of $2,871, representing one year of debt service, which is invested by the Bond Trustee.	29,075
5.60% Term Bonds maturing March 1, 2020	3,560
5.50% Term Bonds maturing March 1, 2030	5,435
Add: premium on 2000 Bonds	129
Total 2000 Series A Bonds	38,199
2002 Series A Revenue Bonds ($43,020)	
Serial Bonds, maturing from 2002 to 2012, with annual principal payments from $310 to $1,525 and coupon interest rates from 2.0% to 5.375%. A balloon payment of $31,915 is due in 2012.	43,020
Add premium	2,640
Total 2002 Series A Bonds	45,660
Total Bonds Payable	$ 130,856

Costs associated with the issuance of the 1998, 2000, and 2002 Series A revenue bonds have been recorded in the accompanying Statement of Net Assets as an asset and are being amortized over the life of the related bond issuance. The discount on the 1998 Series A bonds and the premiums on the 2000 and 2002 Series A bonds are also being amortized over the life of the respective bond issuance.

Principal and interest payments on bonds payable for the next five years and in subsequent five-year periods are as follows:

Year Ending June 30:	Principal	Interest	Total
2003	$ 4,065	$ 6,022	$ 10,087
2004	5,040	6,274	11,314
2005	5,145	6,071	11,216
2006	5,370	5,843	11,213
2007	5,325	5,603	10,928
2008-2012	59,445	23,912	83,357
2013-2017	21,325	9,110	30,435
2018-2022	14,305	4,335	18,640
2023-2027	6,065	1,356	7,421
2028-2032	2,500	326	2,826
	$ 128,585	$ 68,852	$ 197,437

Total interest cost incurred for fiscal year 2002 was $4,591, of which $522 was capitalized.

Interest Swap Agreement

In conjunction with the System's June 2002 issuance of fixed rate revenue bonds, the System entered into an interest rate swap agreement with a financial institution counterparty. The purpose of the agreement was to swap the fixed rate on the underlying debt for a variable rate for the term of the debt, and not for any speculative purposes. Governmental accounting standards do not require that the fair value of the interest agreement be included in the accompanying financial statements. The value of the swap instrument ($165 at June 30, 2002) represents the estimated cost to the System to cancel the agreement and is based on pricing models that consider interest rates and other market factors. Interest rate volatility, time to maturity, and outstanding principal will affect the swap's fair value at subsequent reporting dates. If the System repays the debt on schedule, the value of the swap will reach zero at its final maturity.

8. GRANT REFUNDABLE

The System participates in the Federal Perkins Loan and Nursing Loan Programs. These programs are funded through a combination of Federal and Institutional resources. The portion of these programs that has been funded with Federal funds is ultimately refundable to the U.S. government upon the termination of the System's participation in the programs.

9. RESTRICTED NET ASSETS

The System is the recipient of funds that are subject to various external constraints upon their use, either as to purpose or time. These funds are comprised of the following:

Restricted Nonexpendable:	
Endowment funds	$43,970
Restricted Expendable:	
Research and public service	$4,659
Academic support	6,964
Student financial aid	19,681
Loans	9,238
Capital assets and retirement of debt	21,322
Library	3,606
Other	14,165
	$79,635

10. COMMITMENTS AND CONTINGENCIES

The System participates in a number of federal programs subject to financial and compliance audits. The amount of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although the System does not expect these amounts, if any, to be material to the financial statements.

The System is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries; and natural disasters. The System manages these risks through a combination of participation in a public entity risk pool, commercial insurance policies purchased in the name of the System, and through self-insurance programs for workers' compensation claims and physical damage to automobiles.

The System participates in a public entity risk pool with the State of Maine. The System pays an annual premium to the State of Maine for its property and boiler insurance coverage. The risk pool is self- sustaining through member premiums and reinsures through commercial companies for claims in excess of coverage provided by the fund. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years.

It is the policy of the System not to purchase commercial insurance for the risk of loss related to workers' compensation. Instead, the System's management believes it is more economical to manage its risk internally and to set aside assets for claims settlement. The liability for unpaid claims is based on the requirements of Governmental Accounting Standards Board Statement No. 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Changes in the workers' compensation claims liability amount in fiscal 2002 were as follows:

	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year-End
2001	$2,431	$1,616	$1,349	$2,698
2002	$2,698	$1,183	$1,167	$2,714

The above noted liability for workers' compensation is included in the accompanying statement of net assets as part of total accrued liabilities of $45,276 at June 30, 2002 (see note 7).

The System continues to carry commercial insurance for all other risk of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

11. GRANTS AWARDED, NOT EXPENDED

The System defers recognition of grants awarded, not expended, until such time as the services required to fulfill the terms of the grant are performed. Accordingly, the financial statements do not reflect the balance of such grants awarded to the System, which amount to $48,421 at June 30, 2002. Under the terms of certain of these grants, the System is required to provide matching funds.

12. RETIREMENT BENEFITS

The System has two primary pension plans. Eligible salaried employees participate in the University of Maine System Retirement Plan for Faculty and Professional Employees. Eligible hourly paid employees participate in the University of Maine System Basic Retirement Plan for Classified Employees.

Pension expense, excluding social security, amounted to $15,200 in 2002. The System had a total payroll of $220,900 in 2002, of which $205,600 was covered by one of the two System pension plans.

In addition to providing pension benefits, the System provides certain health care benefits for retired employees. The cost of retiree health care benefits is recognized as expense when paid and totaled $5,000 in 2002.

Retirement Plan for Faculty and Professional Employees

The System's faculty and professional employees participate in a defined contribution retirement plan administered by the Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF). The Board of Trustees and collective bargaining agreements establish the mandatory rates of contributions for employees and the System. The System contribution to this Plan was $14,600 in 2002. The total required contribution to this Plan by employees was $5,900. Covered payroll was $147,400.

All full-time employees are eligible once employment begins. Part-time employees are eligible once they have achieved the equivalency of five years of continuous, full-time, regular service. All eligible employees are required to participate in this Plan when they reach thirty years of age.

The System contributes 10% of participants' base salary and participants contribute 4% of their base salary. Participant and System contributions are fully and immediately vested. Participants may direct up to 60% of existing accumulations and/or future contributions to selected investment vehicles outside of TIAA/CREF.

Upon separation from the System, participants may withdraw up to 60% of the funds from their accounts, or transfer funds to other investment alternatives subject to Internal Revenue Service limitations and the contractual provisions of the Plan.

Incentive retirement benefits are paid to participants who retire upon the attainment of age 55 and have completed at least ten years of continuous service. The benefit is computed in accordance with the normal retirement benefit.

Basic Retirement Plan for Classified Employees

The Retirement Plan for Classified Employees consists of a defined contribution plan and a defined benefit plan. The Defined Contribution Plan was established on July 1, 1998. It covers new employees, most employees under age 50, and employees 50 years and older who elected to participate. The Defined Benefit Retirement Plan for Classified Staff is maintained for eligible employees who chose not to join the new plan.

Defined Contribution Plan

The Defined Contribution Program of the Basic Retirement Plan for Classified Employees was created on July 1, 1998. Classified employees hired July 1, 1998 or later participate in the Defined Contribution Program. Most eligible employees who were hired before July 1, 1998 and who were younger than age 50 as of June 30, 1998 rolled over the value of their accrued benefit from the Defined Benefit Retirement Plan for Classified Staff. Eligible employees who were hired before July 1, 1998 and who were age 50 or older on June 30, 1998 could elect to roll over the value of their accrued benefit and join the defined contribution plan or to remain in the defined benefit plan.

Full-time employees are eligible to participate once employment begins. Part-time employees are eligible once they have achieved the equivalency of five years of continuous, full-time regular service.

Upon separation from the System, participants may withdraw up to 40% of the funds from their accounts, or transfer funds to other investment alternatives subject to Internal Revenue Service limitations and the contractual provisions of the Plan.

Employees hired July 1, 1998 or later are required to contribute 1% of base pay to the plan and may contribute up to 4%. Their contributions are matched by an equal contribution by the System (i.e. up to 4%). Employees hired prior to July 1, 1998 and who have less than five years of service may voluntarily contribute up to 4% of base pay and receive an equal matching contribution from the System.

Employees who have five or more years of completed service receive a System contribution of 6% of base pay. These employees may voluntarily contribute 1% to 4% of base pay and receive a 100% match (i.e., up to 4%) from the System.

Defined Benefit Retirement Plan for Classified Staff

Normal retirement benefits are paid to participants who attain age 65 and retire. The monthly retirement benefit is based on a formula specified by policy in collective bargaining agreements.

Employees who participate in the Defined Benefit Retirement Plan may also participate in the Optional Retirement Savings Plan (ORSP). The ORSP is a voluntary defined contribution plan. The employee may contribute up to 4% of base pay and receive a 100% match from the System. The ORSP is administered by TIAA-CREF.

Early retirement benefits are paid to participants who retire upon the attainment of age 55 and who have completed five years of continuous service. The benefit is computed in accordance with the normal retirement benefit, but is reduced by an actuarial factor because benefits will be paid over a longer period of time. No reduction is made if an employee retires after attaining 62 years of age with twenty-five (25) or more years of service.

Deferred vested benefits are paid to participants who have attained five or more years of continuous service. Participants are also eligible for Disability and Death benefits.

The amount shown below as "Pension Benefit Obligation" is a standardized disclosure measurement of the actuarial present value of credited projected pension benefits, adjusted for the effects of projected salary increases and any step-rate benefits estimated to be payable in the future as a result of employee service to date.

The Pension Benefit Obligation was determined as part of an actuarial valuation of the Plan, as of July 1, 2002. Significant actuarial assumptions used in determining the pension benefit obligation include: an annual rate of investment return of 6.5%, a discount rate of 6.5%, and an annual rate of salary increase of 4%. The Plan's assets consist principally of equities, bonds, and cash equivalents. The table below shows the funding status of the Defined Benefit Retirement Plan.

PENSION BENEFIT OBLIGATION

Total Pension Benefit Obligation	$ 58,005
Valuation assets (market value = $65,375)	68,644
Net assets in excess of pension benefit obligation	$ 10,639

These assets and liabilities are not included in the System's financial statements since they are held in a separate benefit plan. The System funding policy for the Plan is to ensure that the Plan is funded as actuarially determined by the Pension Benefit Obligation. The calculated contribution is based on the Plan's normal cost for the year reduced by a fifteen-year amortization of the excess of valuation assets over the Plan's actuarial accrued liability. The Projected Unit Credit Actuarial Cost Method has been used in this valuation. Under this method, the service cost is determined as the actuarial present value of that portion of each participant's projected benefit attributable to service expected to be earned in the current Plan year.

The Projected Benefit Obligation, which is re-determined for each employee as of each valuation date, represents the actuarial present value of the portion of each participant's projected benefit attributable to service earned prior to the valuation date. The significant actuarial assumptions used to compute the calculated contribution are the same as those used to compute the Pension Benefit Obligation. The calculated contribution for the current fiscal year is as follows:

Actuarially determined normal cost	$3,100
Amortization of excess valuation assets over actuarial accrued liability	(1,131)
Calculated contribution	$1,969

The normal actuarial cost represents 6.7% of the covered payroll for this Plan.

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. Information for the past three fiscal years is presented below:

July 1:	(1) Net Assets Available for Benefits	(2) Pension Benefit Obligation	Percentage Funded (1) / (2)	(3) Overfunded Pension Benefit Obligation (1) - (2)	(4) Annual Covered Payroll	Overfunded Pension Benefit Obligation as a % of Payroll (3) / (4)
2000	$73,928	$57,601	128.35%	$16,327	$42,000	38.9%
2001	$69,230	$55,033	125.80%	$14,197	$45,000	31.5%
2002	$68,644	$58,005	118.34%	$10,639	$46,000	23.1%

13. UNIVERSITY OF MAINE FOUNDATION

The University of Maine Foundation (the "Foundation") is an independent non-profit organization and, accordingly, its financial statements are not consolidated with those of the System. Total gifts and income received by the System from the Foundation during the fiscal year ended June 30, 2002 were $4,200. The reported fair market value of the Foundation's assets at June 30, 2002 was $101,100**.**

In May 2002, GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. GASB 39 establishes new criteria for evaluating the need to include the Foundation as a component unit of the System. The Foundation appears to meet these revised criteria and, accordingly, is expected to be included as a component in the future. The System will adopt GASB 39 as of July 1, 2003.

14. PASS THROUGH GRANTS

The System distributed $9,279 for student loans through the U.S. Department of Education Federal Direct Lending Program. These distributions and related funding sources are not included as expenses and revenues nor as cash disbursements and cash receipts in the accompanying financial statements.

15. RECONCILIATION OF BEGINNING NET ASSETS

The provisions of GASB Statements No. 34 and 35 have been applied to the beginning net assets. The following is a reconciliation of total fund balances as of June 30, 2001 as reported in last year's financial statements to the total net assets that would have been reported had GASB Statements No. 34 and 35 been in effect as of June 30, 2001:

Total fund balances as previously reported	$461,697
Federal portion of Perkins and Nursing Loan Programs	(27,958)
Library materials net of depreciation	24,062
Other	(6,009)
Total beginning net assets	$451,792

99 High Street
Boston, MA 02110-2371

Telephone 617 988 1000
Fax 617 988 0800

Auditors' Report on Compliance and on Internal Control Over Financial Reporting in Accordance With *Government Auditing Standards*

The Board of Trustees
University of Maine System:

We have audited the financial statements of the University of Maine System (a component unit of the State of Maine) (the System) as of and for the year ended June 30, 2002, and have issued our report thereon dated September 13, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control over financial reporting.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses.

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of management, the Board of Trustees and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

September 13, 2002